



STATE OF ALASKA
RETIREE HEALTH FUND
(an Internal Service Fund of the State of Alaska)

Financial Statements

June 30, 1999 and 1998

STATE OF ALASKA
RETIREE HEALTH FUND
(an Internal Service Fund of the State of Alaska)

June 30, 1999 and 1998

Table of Contents

| | Page |
|---|-------------|
| Independent Auditors' Report | 1 |
| Balance Sheets | 2 |
| Statements of Revenues, Expenses and Changes in Retained Earnings | 3 |
| Statements of Cash Flows | 4 |
| Notes to Financial Statements | 5-8 |
| Required Supplementary Information—Year 2000 (Unaudited) | 9-10 |



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Independent Auditors' Report

Division of Retirement and Benefits
Retiree Health Fund:

We have audited the accompanying balance sheets of the State of Alaska Retiree Health Fund (Plan), an Internal Service Fund of the State of Alaska, as of June 30, 1999 and 1998, and the related statements of revenues, expenses and changes in retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Alaska Retiree Health Fund (Plan), an Internal Service Fund of the State of Alaska, as of June 30, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The year 2000 required supplementary information on pages 9 and 10 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because of the nature of the subject matter underlying the disclosure requirements and because sufficiently specific criteria regarding the matters to be disclosed have not been established. In addition, we do not provide assurance that the Plan is or will become Year 2000 compliant, that the Plan's Year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Plan does business are or will become Year 2000 compliant.

KPMG LLP

September 24, 1999



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**STATE OF ALASKA
RETIREE HEALTH FUND**
(An Internal Service Fund of the State of Alaska)

Balance Sheets
June 30, 1999 and 1998

| Assets | 1999 | 1998 |
|--|---------------|------------|
| Cash and cash equivalents: | | |
| Investment in State of Alaska General Fund and other nonsegregated investments pool (note 3) | \$ 3,751,541 | 35,800,043 |
| Deposit with NYLCare (notes 3 and 4) | 3,942,141 | 555,490 |
| Total cash and cash equivalents | 7,693,682 | 36,355,533 |
| Investments (note 3): | | |
| Short-term fixed income pool | 25,889,850 | — |
| Intermediate-term fixed income pool | 17,131,169 | — |
| No constraint fixed income pool | 25,188,165 | — |
| Total investments | 68,209,184 | — |
| Premiums receivable (note 6) | 4,434,012 | 22,000,000 |
| Due from retirement systems | 144,974 | — |
| Total assets | \$ 80,481,852 | 58,355,533 |
| Liabilities and Retained Earnings | | |
| Liabilities: | | |
| Estimated claims incurred but not paid (note 5): | | |
| Medical, dental, visual and audio | \$ 24,928,000 | 20,418,401 |
| Long-term care | 2,820,000 | — |
| Total estimated claims incurred but not paid | 27,748,000 | 20,418,401 |
| Due to State of Alaska General Fund | 2,450,788 | — |
| Accrued expenses | 1,794,291 | 323,424 |
| Total liabilities | 31,993,079 | 20,741,825 |
| Retained earnings (deficit): | | |
| Major medical | 12,778,444 | 11,817,509 |
| Dental, visual and audio | 1,876,581 | (346,380) |
| Long-term care | 33,833,748 | 26,142,579 |
| Total retained earnings | 48,488,773 | 37,613,708 |
| Total liabilities and retained earnings | \$ 80,481,852 | 58,355,533 |

See accompanying notes to financial statements.

**STATE OF ALASKA
RETIREE HEALTH FUND**

(An Internal Service Fund of the State of Alaska)

Statements of Revenues, Expenses and Changes in Retained Earnings

Years ended June 30, 1999 and 1998

| | <u>1999</u> | <u>1998</u> |
|--------------------------------------|----------------------|--------------------|
| Revenues: | | |
| Health insurance premiums (note 6) | \$ 126,084,866 | 131,652,324 |
| Other | 88,122 | — |
| Total revenues | <u>126,172,988</u> | <u>131,652,324</u> |
| Expenses: | | |
| Benefits | 111,356,041 | 92,188,450 |
| Administrative expenses | <u>5,781,464</u> | <u>3,903,390</u> |
| Total expenses | 117,137,505 | 96,091,840 |
| Operating income | 9,035,483 | 35,560,484 |
| Investment income | <u>1,839,582</u> | <u>2,053,224</u> |
| Net income | 10,875,065 | 37,613,708 |
| Retained earnings, beginning of year | <u>37,613,708</u> | — |
| Retained earnings, end of year | <u>\$ 48,488,773</u> | <u>37,613,708</u> |

See accompanying notes to financial statements.

STATE OF ALASKA
RETIREE HEALTH FUND
(An Internal Service Fund of the State of Alaska)

Statements of Cash Flows
Years ended June 30, 1999 and 1998

| | <u>1999</u> | <u>1998</u> |
|---|---------------------|-------------------|
| Operating activities: | | |
| Operating income | \$ 9,035,483 | 35,560,484 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| (Increase) decrease in premiums receivable | 17,565,988 | (22,000,000) |
| Increase in accrued expenses | 1,470,867 | 323,424 |
| Increase in estimated claims incurred but not paid | 7,329,599 | 20,418,401 |
| Increase in due from retirement systems | (144,974) | — |
| Increase in due to State of Alaska General Fund | 2,450,788 | — |
| Net cash provided by operating activities | <u>37,707,751</u> | <u>34,302,309</u> |
| Investing activities: | | |
| Investment income received | 1,839,582 | 2,053,224 |
| Net purchases of investments | <u>(68,209,184)</u> | <u>—</u> |
| Net cash provided by (used in) investing activities | <u>(66,369,602)</u> | <u>2,053,224</u> |
| Net increase (decrease) in cash | (28,661,851) | 36,355,533 |
| Cash and cash equivalents, beginning of year | <u>36,355,533</u> | <u>—</u> |
| Cash and cash equivalents, end of year | <u>\$ 7,693,682</u> | <u>36,355,533</u> |

See accompanying notes to financial statements.

STATE OF ALASKA
RETIREE HEALTH FUND
(an Internal Service Fund of the State of Alaska)

Notes to Financial Statements

June 30, 1999

(1) Description

The following brief description of the State of Alaska Retiree Health Fund (Plan), an internal service fund of the State of Alaska (State), is provided for general information purposes only. Participants should refer to the Retiree Group Insurance Information Booklet for more complete information.

(a) General

The Plan was established to provide self-insured healthcare benefits to retirees of the Public Employees' Retirement System, Teachers' Retirement System, Judicial Retirement System and Elected Public Officers Retirement System (collectively referred to as the Retirement Systems) beginning July 1, 1997. The Plan is an internal service fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial report. As of June 30, 1999 and 1998, there were approximately 19,700 and 19,000 retirees, respectively, excluding dependents, covered by the Plan.

Prior to July 1, 1997, healthcare benefits for retirees were fully insured through the payment of premiums to an insurance company.

(b) Benefits

The Plan offers major medical, voluntary dental-visual-audio (DVA) and voluntary long-term care (LTC) benefits to eligible benefit recipients of the Retirement Systems and their dependents.

Medical

The Plan covers, automatically at no cost, benefit recipients of the Retirement Systems, as well as benefit recipients of the Marine Engineers Beneficial Association who retired from the State after July 1, 1986, except for the following who must elect coverage and pay a premium:

- Benefit recipients of the Public Employees' Retirement System (PERS) if they were first hired under the PERS on or after July 1, 1986, who are under age 65 and are not receiving a disability benefit.
- Benefit recipients of the Teachers' Retirement System (TRS) if they were first hired under the TRS on or after July 1, 1990, who are under age 65 and are not receiving a disability benefit.
- Benefit recipients of the PERS if they were first hired under the PERS on or after July 1, 1996, are age 65 or older and who do not have at least 10 years of credited service.
- Benefit recipients under a Qualified Domestic Relations Order (QDRO).

Voluntary DVA and LTC

Individuals receiving benefits from one of the Retirement Systems, excluding alternate payees under a QDRO, may elect coverage for themselves and their eligible dependents. If coverage is elected, the premiums are paid by deductions from retirement checks.

STATE OF ALASKA
RETIREE HEALTH FUND
(an Internal Service Fund of the State of Alaska)

Notes to Financial Statements

June 30, 1999

(c) Administration

The Plan is administered by the State's Division of Retirement and Benefits (DRB). DRB utilizes the services of a claims administrator, NYLCare Health Plans (NYLCare), to process all medical, dental and audio claims. NYLCare has contracted with Express Scripts, Inc. (ESI) to process all prescription drug claims for the State. Vision benefits provided by the Plan are administered by Vision Service Plan (VSP).

(d) Funding

The Plan is self-insured for all benefits. The Plan's funding policy provides for the collection of premiums from the Retirement Systems and benefit recipients, as applicable. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The Retirement Systems retain the risk of loss of allowable claims.

(2) Summary Of Significant Accounting Policies

(a) Basis of Accounting

The Plan's financial statements are prepared using the accrual basis of accounting. Premiums are recognized in the period in which they are due. Benefits are recognized when due and payable.

(b) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) Investments

Investments are recorded at fair value. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller - that is, other than in a forced or liquidation sale."

The Plan is a participant in the State's General Fund and Other Non-Segregated Investments (GeFONSI) pool. GeFONSI is comprised of the invested assets of the State General Fund and certain other funds that are commingled for investment purposes. GeFONSI invests primarily in pooled marketable debt securities.

STATE OF ALASKA
RETIREE HEALTH FUND
(an Internal Service Fund of the State of Alaska)

Notes to Financial Statements

June 30, 1999

The Plan also participates in the State's Short-Term, Intermediate-Term and No-Constraint Fixed Income Pools. These pools invest primarily in marketable debt securities with varying maturities as follows:

| | |
|-------------------|-------------------------|
| Short-Term | 14 months or less |
| Intermediate-Term | Five years or less |
| No-Constraint | No maturity constraints |

Fair value pricing of pooled marketable debt securities is performed daily by the custodian utilizing an independent pricing service. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates, if applicable. Securities not traded on a national or international exchange are based on equivalent values of comparable securities with interest rates for similar instruments. Fair value has been established as the midpoint between the bid and asked prices. The cost of debt and equity investments is determined on the average cost basis.

Investment income on the above pools, which includes interest and realized and unrealized gains and losses, is calculated and credited daily to each participant on a pro rata basis.

(d) Statement of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include the Plan's investment in GeFONSI and the Plan's deposit with NYLCare. Both of these balances have the general characteristics of demand deposit accounts.

(e) Reclassifications

Certain amounts in the 1998 financial statements have been reclassified to conform to the 1999 presentation.

(f) Federal Income Tax Status

The Plan is exempt from federal income taxes under Section 501(a),

(3) Custodial Credit Risk

The Governmental Accounting Standards Board (GASB) Statement No. 3 requires a disclosure regarding custodial credit risk to indicate the chance of loss in the event a financial institution or third party holding the Plan's securities fails. The Plan's GeFONSI balance, as well as its investments in other State fixed income pools, represents participation in pools rather than ownership of specific securities. All of the underlying securities in the pools in which the Plan participates are considered to be Category 1 as defined by GASB Statement No. 3. As such, investments are insured or registered, or securities are held by the State or its custodian in the State's name. Category 1 is the highest level of safekeeping security as defined by GASB.

The deposit with NYLCare (note 4) is classified as Category 3 because the related bank account is not in the State's name.

**STATE OF ALASKA
RETIREE HEALTH FUND**
(an Internal Service Fund of the State of Alaska)

Notes to Financial Statements

June 30, 1999 and 1998

(4) Deposit With NYLCare

The Plan is required to maintain a cash balance with NYLCare for the payment of medical, dental and audio claims. The cash balance also facilitates the payment of valid prescription drug and vision claims and is used to pay ESI and VSP, respectively. Amounts disbursed from the cash balance are reimbursed by the Plan to NYLCare on a weekly basis.

(5) Claims Incurred But Not Paid

The liability for claims incurred but not paid represents the estimated amounts necessary to settle all outstanding claims, including those which are incurred but not reported, as of the balance sheet date. The Plan's reserve estimates are based primarily on historical development patterns adjusted for current trends that would modify past experience. The process of establishing loss reserves is subject to uncertainties that are normal, recurring and inherent in the health insurance business.

(6) Premiums

During the year ended June 30, 1999 and 1998, the Plan received refunds of \$5,075,553 and \$9,000,000, respectively, which consisted of reserves from the insurance company which provided coverage to retirees prior to July 1, 1997, respectively. These reserves were retained by the insurance company to cover claims submitted subsequent to July 1, 1997, but incurred prior to that date. The refund amounts are reflected as health insurance premiums in the financial statements and were identifiable to medical, dental and audio premium reserves. At June 30, 1999, the Plan is awaiting the return of an additional \$4,352,011 of these reserves from the same insurance company. This amount is reflected as premiums receivable in the financial statements and is considered fully collectible by the Plan.

During the year ended June 30, 1999, the Plan received \$27,899,896 of reserves from the same insurance company related to long-term care. A majority of this amount was recorded as a receivable, and correspondingly as health insurance premiums, at June 30, 1998, based on the Plan's estimate of the reserves to be returned. The amount received during 1999 in excess of the June 30, 1998 receivable balance is reflected as health insurance premiums in the financial statements.

**STATE OF ALASKA
RETIREE HEALTH FUND**

Required Supplementary Information – Year 2000 (Unaudited)

The Year 2000 issue, in general, involves shortcomings in many data processing systems that could cause systems to shut down or to miscalculate certain information connected to date values. Year 2000 readiness is critical to the Plan and its members. The data processing systems the Plan depends on must be able to operate in the Year 2000 and the future as they do currently.

The Plan has made a review of its systems that can be affected and are necessary to the conduct of the Plan's operations.

The Plan depends on several types of data processing systems, of which there are many.

(a) Internal Systems

These are systems that the Plan uses internally, *directly under its control*, to process data it has received (employee indicative data, payroll contributions, account summary information, WEB applications, etc.) and to pass on data to other systems that process it further (contribution information, indicative data changes, distribution authorizations, etc.).

(b) External Systems

These are systems that the Plan depends on, *NOT under the direct control of the Plan*, that send member information to the Plan (state and political subdivision payroll information and indicative data, etc.), systems that handle the transfer of data (networks and centralized data processing systems outside the control of the Division), systems that perform various functions for members (detailed statement accounting, investment transactions, etc.), and general systems such as the nationwide banking system that everyone depends on.

In turn, these outsource operators are further dependant on other providers they must interact with that are NOT under their direct control (fund managers, custodians, etc.).

(c) General Infrastructure Systems

These are systems that the Plan and External providers depend on, *NOT under the direct control of the Plan*, that allow both of the system types indicated above to operate. They include electrical, telephone, internet, postal, and other utilities.

Several detailed processes have been used to achieve Year 2000 readiness. Since the Plan has no control over General Infrastructure components it has conducted its Year 2000 assessment and remediation process assuming the infrastructure components to be in working order for Year 2000 purposes:

- *Awareness Stage*—The Plan established a project plan for dealing with Year 2000 issues. Expenditures in conjunction with the correcting Year 2000 issues are expensed as incurred and have not been, nor are they expected to be, material to the Plan's financial statements.
- *Assessment Stage*—Inventories were made of the various system components (both Internal and External) and identified those that are mission critical and must be Year 2000 ready.

**STATE OF ALASKA
RETIREE HEALTH FUND**

Required Supplementary Information – Year 2000 (Unaudited)

- *Remediation Stage –*

1. For Internal systems—Mission critical components were tested by Plan employed personnel or contractors and the extent and type of repair was determined, if found necessary.
2. For External systems—The Plan depends on assurances from outside organizations that are responsible for such systems.

- *Validation\Testing Stage*—The Plan has conducted specific tests to determine Year 2000 readiness. Programs and systems were converted and renovated to fix existing problems. The Year 2000 changes were also moved into production.

For Internal systems, personnel or contractors under the Plan's direct control conducted such testing and validation. In the case of External systems, the Plan depends on assurances from the organizations that are responsible for those systems. However, specific test files which contained Year 2000 test data were submitted by the Plan to the outsource organization to determine their Year 2000 readiness.

- *Contingency Planning*—In the unlikely event a Year 2000 related interruption of the Plan's systems does occur, prepared contingency plans, for systems under the Plan's control, will be activated to minimize impacts on Plan operations.

The Plan is expected to transition successfully to Year 2000 with a minimum of disruption. However, there can be no absolute assurances that every system will be flawlessly Year 2000 ready by December 31, 1999, or that the Plan will not suffer unexpected material adverse consequences as a result of failure of computer systems or imbedded chips to recognize the Year 2000. It is also possible that the failure of entities beyond the control of the Plan and the State of Alaska could have a material impact on the operation or finances of the Plan.

As the U.S. Securities and Exchange Commission stated in its first report to Congress on the Year 2000 issue:

“It is not, and will not, be possible for any single entity or collective enterprise to represent that it has achieved complete Year 2000 compliance and thus guarantee its remediation efforts. The problem is simply too complex for such a claim to have any legitimacy. Efforts to solve Year 2000 problems are best described as ‘risk mitigation.’ Success...will have been achieved if the number and seriousness of any technical failures is minimized, and they are quickly identified and repaired if they occur.”

The Plan agrees with that philosophy and has taken positive, direct steps to remain Year 2000 ready.

To the maximum extent permissible under the Federal Year 2000 Information and Readiness Disclosure Act of 1998, and for all purposes not expressly excluded under that Act, the information provided above is a Year 2000 readiness disclosure statement made under that Act.